



REGULATION OF AUDITORS OF LOCAL PUBLIC BODIES –
A CONSULTATION DOCUMENT ON FRC REGULATIONS
AND STATUTORY GUIDANCE UNDER THE LOCAL AUDIT
AND ACCOUNTABILITY ACT 2014

ICAS RESPONSE

OCTOBER 2014

Introduction

ICAS welcomes the opportunity to comment on the Financial Reporting Council's ('the FRC's') consultation on the Regulation of Auditors of Local Public Bodies. ICAS considers this to be an important sector with wide public interest.

In considering our response we consulted with the ICAS Public Sector Committee which is a broad based committee of ICAS Members, which includes representation from a number of Members working within the public sector across a range of different public service areas throughout the UK. Membership of this committee includes representation from public sector auditors.

Background to ICAS

ICAS received its Royal Charter in 1854 and is the oldest professional body of accountants in the world. We were the first body to adopt the designation "Chartered Accountant" and the designatory letters "CA" are the exclusive privilege of Members of ICAS in the UK.

ICAS is a professional body for over 20,000 members who work in the UK and in more than 100 countries around the world. Our CA qualification is internationally recognised and respected. We are a highly respected regulator.

We are a Recognised Supervisory Body for statutory audit in the United Kingdom (supervised by the FRC), a Designated Professional Body for incidental investment business (supervised by the Financial Conduct Authority) and we are a Recognised Professional Body for insolvency licensing and regulation (supervised by the Insolvency Service).

As the ICAS Charter requires, we act in the public interest and our proactive projects, and responses to consultation documents, are therefore intended to place the general public interest first, notwithstanding our Charter requirements to represent and protect our Members' interests.

We consider the public interest in this instance to be the protection of the general public and public finances following the abolition of the Audit Commission and to ensure the appropriate and proportionate regulation of auditors of such bodies.

A significant number of our practising members work within the public sector or are involved in the audit of public sector bodies. We also have a significant number of Members and Firms based in England and Wales. This consultation is therefore of interest and importance.

Executive Summary

ICAS understands the concerns of the FRC following the abolition of the Audit Commission and the inherent public interest aspect of local public audits. We recognise the need for oversight and regulation of local public auditors, given these bodies are publicly funded and therefore the public interest aspect is high.

We have consulted with the members of our Public Sector Committee and our Firms on the proposals. Understandably there is some concern that the proposals will create unnecessary complexity in relation to audit regulation in the UK. Our Public Sector Committee is particularly concerned that the proposal overstates sector differences and sets a precedent for the future. All members of RSB Bodies have subscribed to the Code of Ethics and therefore Engagement Leads would be ethically bound to only accept work which they are competent to undertake. We believe that these fundamental principles are just as influential over the profession as prescribed rules.

Notwithstanding the above, as a regulator, ICAS acknowledge the increasing movement towards the regulation of specialisms and services. We recognise the need for the FRC to ensure that public sector audit is undertaken by competent Engagement Leads but we differ in our views on how that might best be achieved. For example, a number of the proposals, as currently drafted, are either already in place within the Recognised Supervisory Bodies (RSBs) for the purposes of statutory audit, or the existing arrangements could be easily modified without the need for a new regulatory scheme.

Our response to the consultation paper is intended to be helpful to the FRC, as it seeks to develop an appropriate regulatory model for public sector audit. As an RSB we will implement the proposals which the FRC introduces in due course but we would encourage the FRC to give further consideration to how its aims might be best achieved.

In summary, our main comments on the consultation are as follows:

Transparency reporting:

- The publication of transparency reports for major local bodies is in the public interest and mirrors existing practice in the private sector. We consider this proposal would affect only a small number of firms, most of whom are already publishing such reports.
- We agree that only one transparency report should be published per firm covering both private and public sector major audits, avoiding unnecessary reporting for each sector specialism.

Register of local public auditors:

- We are not clear on the rationale for the FRC requiring a separate register of local public auditors. The RSBs already maintain a Joint Audit Register (JAR) in digital format, and it may be more effective and efficient to simply amend the JAR to be able to recognise whether a firm is authorised to conduct public sector audit (thereby enabling both registers to be combined but, with the ability to operate separate search and reporting functions). This is particularly relevant if, ultimately, there is any further segmentation of the audit market in the future. One register covering all sectors may avoid unnecessary duplication and cost and confusion for the public and consumers. There is also an inherent risk of errors where separate registers having to be maintained. There are different cost implications with a separate or joint register and a cost benefit analysis of each approach would be beneficial.

Engagement leads:

- As an overarching comment, ICAS would caution against the unnecessary segmentation of the audit market. Currently there are no other sectors or industries where a different approach is taken to audit regulation and ICAS considers that a holistic approach should be maintained where possible. The case has not been made out to differentiate public sector audits regulation from other sectors.
- We believe that the current RSB arrangements for approving, registering and monitoring Responsible Individuals for the purpose of statutory audit (under the Companies Act 2006) can be adequately adapted to accommodate the authorisation of local public Engagement Leads without causing undue expense and regulatory burden to our audit firms. The RSBs would be subject to the supervision of the FRC in this respect and, to that extent, the FRC could ensure adequate safeguards and procedures were in place. This would be more in keeping with the spirit of the Regulators' Code, than creating a new regulatory regime with restrictive practical experience requirements. There is a possible risk that such prescribed regulatory requirements could reduce the market to those firms already engaged in public sector audit at present, thereby limiting future competition.
- We therefore request that the FRC give further consideration to the existing arrangements and the way in which these could be strengthened or expanded to accommodate the main requirements of this consultation without going as far as to establish a new regulatory regime.

ICAS Response to FRC Consultation Questions

Question 1

Do you agree that the requirement to publish transparency reports should be restricted to auditors of “major local audits” (paragraph 4.4.1)?

ICAS understands that local public bodies are entities of significant public interest.

The Government's Regulators' Code requires that regulators should base their compliance activities on risk and ICAS therefore concurs with the FRC view that transparency reporting requirements should be restricted to only those entities which have the greatest level of public interest or perceived higher levels of risk. To widen the transparency reporting requirement to auditors of all local audits would appear unwarranted and would create an unnecessary compliance burden on audit firms.

The FRC proposes to set a threshold, so that only the auditors of the largest public bodies will be required to complete a transparency report. The financial limits set of gross income or gross expenditure for the financial year in excess of £500 million, which limits the number of entities within scope to 200 bodies, appears a reasonable criteria. This is consistent with the turnover limits already set by the FRC for unquoted private companies being considered 'major audits'. There may, however, be other risk factors, such as the nature of the public services provided, that could also be taken into account in the public interest, however we recognise that this is more of a subjective assessment and therefore potentially difficult to administer.

In conclusion, if the proposals are approved, ICAS would agree that the transparency reporting requirement should mirror the Companies Act reporting requirements to apply to 'major local audits' only, which would have minimal impact given the majority of such audit firms are already preparing transparency reports and therefore the impact of this proposal should be low.

Question 2

Do you agree that a firm that audits both major local bodies and private sector public interest entities should be able to publish a single transparency report (paragraph 4.4.2)?

Yes we agree that a single transparency report is appropriate.

The Government's Regulators Code states that *'Regulators should avoid imposing unnecessary regulatory burdens through their regulatory activities and should assess whether similar social, environmental and economic outcomes could be achieved by less burdensome means.'*

It is important that there is not duplicate regulation; where there are appropriate schemes already in place we have a responsibility to prevent unnecessary regulatory burden and costs.

ICAS is committed to reducing the regulatory burden and therefore a single transparency report is appropriate.

Most of the transparency report information requirements (as discussed in Question 3) such as governance, quality control, independence arrangements are firm-wide and will be common to both private sector and local public body audits. The requirement to produce two transparency reports, in order to comply with a regulatory requirement, is disproportionate and unnecessary.

The consultation paper identifies that there is approximately only seven audit firms auditing the 200 bodies which would fall within scope, most of which already publish a transparency report. The proposal for a single transparency report would likely be welcomed by the relevant audit firms.

Question 3

Do you agree that (i) the information requirements and (ii) the requirements for publication should follow as closely as possible the existing requirements for auditors of private sector public interest entities (paragraph 4.4.3)?

Yes, we concur that one common report should be adopted and that the information requirements for major local audits should follow as closely as possible the existing requirements for private sector public interest entities. Accordingly, we agree that the transparency report should focus on:

- Legal structure and ownership of the firm;
- Network information;
- Governance;
- Internal quality control systems and a statement on its effective functioning;
- Information regarding the last monitoring visit;
- A list of major audits (including major local audits)
- Independence procedures and confirmation of an internal review of independence practices
- Competence arrangements
- Financial information
- Remuneration of principals

We consider that this should provide the public, and those procuring major local audit services, with the most relevant information. Public reporting encourages compliance.

Question 4

Are there additional information requirements relating to local public audit that we should include as statutory requirements for transparency reports?

No. There are no additional requirements identified.

Question 5

Do you have any specific comments on the draft regulations at Annex A?

No. As these are closely aligned with the existing 2008 regulations we have no further comments.

Question 6

Do you agree that the requirements for the Register of Local Public Auditors should match as closely as possible to the existing FRC requirements for the Register of Statutory Auditors (paragraphs 4.8 and 4.9)?

We agree with the FRC proposal that there should be publicly available information on local public auditors and their Engagement Leads, both in the public interest, and to assist procurers.

We also agree with the FRC that the RSBs should be responsible for maintaining this information, in the same way as the current public audit register and, that this register should match as closely as possible the existing FRC requirements. Nevertheless, we remain unclear as to why the FRC is proposing a separate register rather than modifying the existing register to accommodate local public auditor information. It may be that the FRC has considered and dismissed this option to date (modifications to the JAR would require the consent and co-operation of the RSB bodies for statutory audit).

Maintaining a separate Register of Local Public Auditors may be unnecessary. Duplicating firm and Engagement Lead details across two registers (given most local public auditors firms are also likely to audit private sector audits) may increase the risk of errors.

In Ireland, the Companies Registration Office has different eligibility requirements for statutory auditors and public auditors (for credit union audits for example). Instead of holding two registers the one register discloses whether the firm has dual status or is only a statutory auditor. ICAS proposes that a similar approach could be adopted for the UK.

Without the benefit of a cost benefit analysis between a joint and separate register it is, however, difficult to conclude definitively.

Question 7

Do you have any specific comments on the draft regulations at Annex B?

The draft regulations have been prepared on the basis of the proposition to create a standalone public audit register for local public audit. We don't have any comments as the draft regulations very closely mirror The Statutory Auditors (Registration) Instrument 2008.

As noted above, it may be preferential for the public audit register and statutory audit register to be combined (albeit with the ability to conduct separate search and reporting tasks so that the public can search both criteria). If this proposal commends itself to the FRC then we consider that the 2008 Instrument could be modified to extend to appointments as "local auditor".

Question 8

Do you agree with the overall approach at paragraph 4.17 that the RSB's requirements for approving Engagement Leads need to be rigorous but avoid being too complicated or overly restrictive on allowing access to the local public audit market?

We agree that the process for authorising local public audit Engagement Leads needs to be rigorous in order to ensure that only suitably audit qualified persons with the necessary skills and competence are able to conduct this role. We also agree with the FRC that it should be left to the appropriate Recognised Supervisory Body to register firms and authorise Engagement Leads, where satisfied they have the necessary competence.

We fully support the principle that the arrangements should not be too complicated or overly restrictive, but, arguably, the proposals are too prescriptive. The current RSB regime is deemed to be fit for purpose for statutory audit regulation and should suffice for local public audits. Our position is explained further in our response to Question 9 below.

Question 9

Do you support the detailed proposals, set out at paragraphs 4.18 to 4.28, for the experience and practical training requirements individuals should have to meet for approval?

The FRC proposal is to introduce sector specific experience and practical training requirements for local public audit Engagement Leads, including:

- two years post qualification experience of local public audit and similar audit work in a supervisory role;
- this experience should be gained within the previous five years, and for no more than two years to have elapsed since this experience was obtained; and

- up to date CPD appropriate for someone seeking the role of an Engagement Lead for local public audit.

Whilst we agree with the latter requirement regarding CPD requirements we are concerned that the additional experience requirements may be overly prescriptive. Paragraph 4.18 states that the existing safeguards are inadequate, but these same safeguards operate adequately for statutory audit, across a range of other industries and sectors, including charities, housing associations and further and higher education establishments.

In the spirit of the Regulators' Code, we are not yet convinced that a different regulatory approach is needed for public sector audit but we accept that there is a growing move towards specialisms and/or that the FRC could have particular concerns which have not been articulated in the consultation paper.

Meantime, we are of the view that the current regime could be modified to accommodate the assessment of Engagement Lead applications for local public audit, without the need for the FRC to introduce prescribed experience requirements.

Before progressing with the consultation proposals, we would encourage the FRC to consider aligning the statutory audit and public sector audit approach in the first instance. A more prescribed regime could be introduced for public sector audit where there is established evidence of deficiencies in the regime.

Question 10

Do you support the proposal at para 4.29, that there should be a specific requirement on an RSB to place a specific obligation on a firm undertaking local public audit work to satisfy itself that the Audit Engagement lead has practical auditing experience of the regulatory and reporting requirements relevant to that audit engagement?

ICAS also does not favour the proposal in paragraph 4.29.

As for the proposals set out at paragraph 4.31, we have no objection to the proposal but we would like to make the following observation. In the context of statutory audit, a Responsible Individual must demonstrate competence in all sectors and industries within their audit portfolio. It is also a Fundamental Principle of the Code of Ethics to which the members of all RSB bodies are bound that the individual will only accept work which he/she is competent to undertake. There seems little benefit to make a separate regulation for Engagement Leads in the context of local public audit. Furthermore the firms undertaking public sector audit work already have such safeguards in place and the FRC might be codifying this practice into a regulatory requirement, without due cause.

Question 11

Do you have additional or alternative requirements that you consider should apply to those wishing to take on the responsibility as an Engagement Lead within a firm registered for local public audit?

No. As stated above, we consider that the regulatory requirements pertaining to statutory audit ought to be capable of application to local public audit without the need for enhanced regulatory requirements.

To this extent, we would encourage the FRC to reflect upon the proposals set out in the consultation paper and give further consideration to the extent to which the current regulatory arrangements can be adapted for local public audit.